
FRBSF WEEKLY LETTER

April 27, 1990

Western Banks Outpace the Nation

Throughout most of the western region, banks reported strong earnings in 1989. Return on assets (ROA) exceeded one percent in the aggregate, a remarkable performance, compared to the 0.48 percent average ROA for the ten-year period ending in 1989. Improved asset quality and interest margins, stringent cost control, and asset growth all contributed to this record-breaking performance. In large measure, the improvement in fundamentals was due to continued economic growth in the region.

In contrast with the West, bank earnings nationally plummeted during the second half, leading to an aggregate ROA in 1989 that was about half the level in the West. Massive additions to northeastern banks' loan loss reserves in the second half account for the weak performance of banks nationwide since such additions are counted as expenses that reduce banks' current earnings.

Strong regional performance

Western bank earnings hit a record \$4.6 billion for the year, compared to \$3.7 billion in 1988. Aggregate ROA for the region rose to 1.01 percent, up from 0.88 percent in 1988. Likewise, return on equity (ROE) rose from 15 percent in 1988 to 16.2 percent in 1989. Earnings generally were strong across all size categories in the West, and the region's largest banking concerns posted exceptionally strong performances, with many reporting ROAs exceeding 1.2 percent.

Moreover, the strong performance was evident throughout most of the region. In fact, seven of the nine states in the region reported ROAs above one percent. Even in Alaska, where the industry has reported losses in the three previous years, banks posted very strong earnings as a result of higher oil prices, a turnaround in the economy, and consolidation of troubled banks. Utah banks posted a still-respectable ROA of 0.66 percent.

Only in Arizona did the industry report an aggregate loss for the year. This loss, which totaled nearly \$500 million and led to an ROA of -1.9 percent, was the result of a \$1 billion expense to replenish loss reserves following massive chargeoffs on real estate and business loans in that state.

Asset quality

Outside Arizona, which has been hit hard by a downturn in the real estate market, the economies of western states have enjoyed at least moderate growth, and are expected to continue in that direction in the near future. The health of the western economy contributed to improved asset quality at most banks. Banks in the region reduced their net losses associated with charging off bad debts by almost nine percent in 1989. And past due and nonperforming loans, an indicator of likely future chargeoffs, also recorded a decline, falling from 5.1 percent of total loans to 4.7 percent.

In contrast, banks' asset quality nationwide apparently deteriorated in 1989. As a proportion of total loans, past due and nonperforming loans rose above five percent nationally, largely as a result of real estate lending problems. Moreover, in the third quarter a number of money center banks set aside large reserves against future international loan losses. And in the fourth quarter, northeastern banks made sizeable additions to domestic loan loss reserves to cover deterioration in real estate loan quality.

Wider margins, stable costs

In the West, wider net interest margins (the difference between banks' yield on assets and the cost of funding those assets) contributed to the record earnings. Western banks' conservative pricing of retail deposits, especially NOW accounts, savings accounts, and money market deposit accounts (together, they account for over

WESTERN BANKING

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40 percent of deposits) appears to have helped boost interest margins, especially earlier in the year when rates on these retail accounts lagged behind the increase in market interest rates.

Western banks' efforts to keep operating costs under control also helped contain overhead expenses in the face of increases in both the number of employees and the number of branches operated by western banks. Increased competition in bank services, especially in California, led to longer operating hours and Saturday banking, and put upward pressure on costs. Nonetheless, banks were able to keep overall costs, including salaries and benefits, from rising as quickly as assets. Consequently, the ratio of net noninterest expenses to total assets, a measure of banks' overhead burden, declined slightly.

Lending and funding patterns

In 1989 western banks' assets grew at nearly a nine percent rate, compared to a 5.4 percent rate for the nation. Western banks recorded an 11.5 percent expansion in total loans, the fastest pace since early in the decade. As in previous years, the increase in loans was concentrated in consumer-oriented loans such as mortgage loans and credit cards.

Because of the rise in real estate values in much of the West, as well as the tax-deductibility of home mortgage interest, mortgage loans grew at a rapid 22 percent pace. Similarly, real estate lines of credit grew at a 42 percent rate, reaching \$9.6 billion. At year-end 1989 real estate loans secured by single family properties accounted for \$65.8 billion of total real estate lending in the region, and commercial real estate loans and construction and land development loans accounted for \$34 billion and \$30 billion, respectively.

Credit card lending and other revolving credit consumer loans also grew rapidly in 1989, at an 18 percent rate, but other types of consumer loans grew slowly. The growth in auto loans, in particular, was sluggish as a result both of intense competition from finance companies and thrifts and of the phase out of interest deductibility for these kinds of loans.

Commercial lending was notably sluggish; total domestic business loans grew only around three percent. Among large corporate borrowers, loan demand was weak because of continued reliance on direct financing through the commercial paper and debt markets. And intense competition from foreign banks and finance companies for middle market and smaller commercial borrowers tended to limit loan growth here as well.

To fund the growth in assets, western banks relied heavily on deposit growth in 1989. Small-denomination time certificates and large certificates of deposit (\$100,000 and over) accounted for most of the eight percent growth in total deposits. As the year progressed, western banks began to rely somewhat more heavily on non-deposit sources of funds, such as federal funds and other wholesale borrowings. Western banks' growing reliance on relatively expensive non-deposit funds and large CDs likely will place upward pressure on the cost of funds in 1990.

Capitalization and the outlook

Preparing for possible challenges ahead, Western banks added nearly \$4 billion (book value) in equity in 1989, mostly from \$3 billion in retained earnings and \$800 million in new equity. As a result, the aggregate ratio of western banks' equity capital-to-assets rose to 6.14 percent, compared to 5.78 percent in 1988.

Increased capitalization provides western banks a larger cushion to face the challenges that lie ahead. Western banks face increased competition for deposits and intensified pressure in lending markets. Moreover, asset quality remains a concern, particularly if the real estate slump in Arizona were to spread to other states. These factors could slow growth, narrow net interest margins, increase overhead expenses, and squeeze earnings. However, increased capitalization and a generally favorable outlook for the western economy should lead to continued strength in 1990.

Gary C. Zimmerman
Economist

REGIONAL BANK DATA

DECEMBER 31, 1989

(Not Seasonally Adjusted, Preliminary Data)

		DISTRICT	ALASKA	ARIZONA	CALIF.	HAWAII	IDAHO	NEVADA	OREGON	UTAH	WASH.
ASSETS AND LIABILITIES -- \$ MILLION (ALL COMMERCIAL BANKS)											
ASSETS	TOTAL	464,229	4,338	26,436	319,394	16,775	8,280	17,004	22,132	11,317	38,551
	FOREIGN	39,369	1	N/A	36,807	1,979	N/A	N/A	N/A	93	488
	DOMESTIC	424,860	4,337	26,436	282,587	14,795	8,280	17,004	22,132	11,224	38,064
LOANS	TOTAL	330,975	1,800	18,248	231,931	10,024	5,347	13,351	14,674	7,257	28,343
	FOREIGN	31,113	0	N/A	29,983	940	N/A	N/A	N/A	N/A	190
	DOMESTIC	299,862	1,799	18,248	201,948	9,084	5,347	13,351	14,674	7,257	28,153
	REAL ESTATE	135,442	647	7,485	100,353	4,501	1,380	2,043	4,593	3,003	11,435
	COMMERCIAL	76,635	682	4,031	51,872	2,452	1,444	1,695	5,298	1,782	7,379
	CONSUMER	59,952	267	4,686	31,575	1,364	1,467	9,267	3,269	1,826	6,231
	AGRICULTURE	5,202	7	493	2,636	30	595	17	343	124	956
	INTERNATIONAL	419	N/A	9	410	0	N/A	N/A	N/A	N/A	0
SECURITIES	TOTAL	42,431	1,665	3,226	21,393	3,027	1,699	1,948	3,844	2,058	3,571
	U.S.T.S.	12,208	1,122	1,186	5,508	872	479	583	968	397	1,092
	SECONDARY MARKET	17,329	181	674	10,263	1,113	704	570	1,517	1,109	1,198
	OTHER SEC.	12,894	362	1,365	5,621	1,042	516	795	1,359	552	1,280
LIABILITIES	TOTAL	435,745	3,906	25,028	300,195	15,725	7,738	15,958	20,635	10,567	35,993
	DOMESTIC	396,376	3,905	25,028	263,388	13,745	7,738	15,958	20,635	10,473	35,505
DEPOSITS	TOTAL	372,287	3,431	23,119	259,425	14,601	6,529	7,829	16,803	9,056	31,495
	FOREIGN	34,241	1	N/A	31,810	1,797	N/A	N/A	N/A	93	540
	DOMESTIC	338,046	3,431	23,119	227,616	12,803	6,529	7,829	16,803	8,963	30,955
	DEMAND	85,879	1,012	4,856	62,417	2,291	1,138	2,032	3,375	1,804	6,954
	TIME AND SAVINGS	252,167	2,418	18,262	165,198	10,512	5,390	5,797	13,428	7,159	24,001
	NOW	32,355	212	2,126	20,792	1,209	771	845	2,256	1,037	3,107
	MMDA	62,451	452	4,941	42,748	2,003	1,060	1,529	2,522	1,494	5,702
	SAVINGS	31,167	336	1,192	22,231	1,440	350	889	1,403	767	2,559
	SMALL TIME	69,490	656	7,638	38,016	2,067	2,534	1,164	5,467	2,864	9,084
	LARGE TIME	56,179	746	2,347	41,054	3,792	650	1,370	1,767	992	3,461
	OTHER BORROWINGS	41,369	425	1,417	22,773	612	1,119	7,453	3,049	1,311	3,210
EQUITY CAPITAL	28,484	432	1,408	19,199	1,050	542	1,046	1,497	750	2,559	
LOAN LOSS RESERVE	7,970	41	680	6,049	152	90	206	204	143	406	
STANDBY LETTERS OF CREDIT		33,531	22	651	29,466	564	116	166	665	281	1,599
LOAN COMMITMENTS		141,570	304	4,458	112,809	4,315	1,049	1,496	4,722	1,624	10,792
LOANS SOLD		82,611	45	1,157	80,634	85	48	58	165	33	388
ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS)											
LOAN LOSS RESERVE (ALL BANKS)		2.41	2.28	3.73	2.61	1.52	1.68	1.54	1.39	1.97	1.43
NET CHARGEOFFS, TOTAL		1.16	1.56	4.44	1.03	0.11	0.29	1.99	0.57	0.93	0.49
REAL ESTATE		0.52	2.08	6.80	0.05	-0.01	0.01	0.77	0.42	0.72	0.46
COMMERCIAL		0.58	1.25	4.89	0.42	0.01	0.20	0.61	0.47	1.19	0.05
CONSUMER		1.77	0.51	2.04	1.85	0.42	0.77	2.52	1.12	1.26	1.08
AGRICULTURE		0.24	N/A	1.15	-2.27	-0.61	0.19	-0.01	0.31	0.30	1.36
PAST DUE & NON-ACCRUAL, TOTAL		4.71	5.28	9.75	4.86	1.30	1.81	4.67	2.45	3.73	3.37
REAL ESTATE		4.46	6.84	16.20	3.71	1.20	2.24	3.54	3.42	5.39	4.88
COMMERCIAL		5.41	6.16	8.91	6.15	1.19	1.92	3.10	2.24	2.68	2.07
CONSUMER		2.98	1.84	2.47	2.71	2.34	1.83	5.29	1.99	3.18	2.01
AGRICULTURE		7.38	20.90	7.99	9.48	5.15	2.08	0.58	2.61	3.23	5.68
EARNINGS AND RETURNS -- \$ MILLION, YEAR-TO-DATE (ALL COMMERCIAL BANKS)											
INCOME	TOTAL	52,071	424	2,941	36,462	1,607	849	2,284	2,251	1,194	4,059
	INTEREST	43,717	359	2,515	30,218	1,423	762	1,999	1,948	1,049	3,443
	FEES & CHARGES	2,183	18	149	1,500	34	41	51	120	61	209
EXPENSES	TOTAL	45,416	368	3,765	30,967	1,316	726	1,817	1,891	1,097	3,470
	INTEREST	23,906	200	1,463	16,651	808	437	887	1,056	605	1,799
	SALARIES	8,170	72	562	5,753	253	114	184	364	162	705
	LOAN LOSS PROVISION	3,577	25	1,052	1,837	31	24	237	112	84	175
	OTHER	9,764	71	688	6,727	223	151	509	359	247	791
INCOME BEFORE TAXES		6,609	56	-825	5,456	291	121	466	360	95	589
TAXES		2,412	9	-334	2,099	104	33	184	110	27	179
NET INCOME		4,601	46	-491	3,707	187	88	308	252	74	431
ROA (%)		1.01	1.08	-1.9	1.17	1.18	1.12	1.95	1.17	0.66	1.17
ROE (%)		16.20	10.70	-35.00	19.30	17.80	16.20	29.40	16.80	9.80	16.80
NET INTEREST MARGIN (%)		4.35	3.72	4.07	4.29	3.89	4.12	7.06	4.14	3.99	4.48
NUMBER OF BANKS		724	7	43	433	20	23	16	49	41	92
NUMBER OF EMPLOYEES		238,593	2,470	17,217	157,149	8,045	4,741	6,258	12,846	6,405	23,462

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Research Department Federal Reserve Bank of San Francisco

P.O. Box 7702
San Francisco, CA 94120

MARKET SHARE STATISTICS

DEPOSITORY INSTITUTIONS REQUIRED TO HOLD RESERVES WITH THE FEDERAL RESERVE ON A WEEKLY BASIS

PERCENT OF COMBINED MARKET TOTAL FOR FEBRUARY 1990, BY REGION

	DISTRICT			ALASKA			ARIZONA			CALIF			HAWAII			IDAHO			NEVADA			OREGON			UTAH			WASH		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	48	48	4	74	5	22	54	42	4	43	53	4	66	29	5	87	10	3	68	29	3	66	28	6	68	22	10	56	37	7
DEMAND	92	4	4	100	0	0	91	4	5	92	4	4	93	4	3	93	1	6	99	1	0	94	1	4	92	3	4	93	4	3
NOW	62	31	7	59	5	36	70	22	9	57	37	6	72	26	3	88	8	3	77	16	6	77	17	6	74	15	11	66	22	12
SAVINGS & MMDA	59	33	8	52	5	43	68	23	9	56	37	7	63	27	10	88	8	4	77	19	5	68	22	10	69	10	21	59	26	15
SMALL TIME	28	68	3	76	8	16	41	56	3	22	75	3	40	57	3	83	15	2	41	57	2	52	43	5	55	38	7	44	52	4
LARGE TIME	39	60	1	92	5	3	37	62	1	35	64	1	79	19	2	85	11	4	70	30	0	75	24	1	76	19	5	44	55	1

CB = COMMERCIAL BANKS; SL = SAVINGS & LOANS AND MUTUAL SAVINGS BANKS; CU = CREDIT UNIONS; MAY NOT SUM TO 100% DUE TO ROUNDING

INTEREST RATES ON DEPOSITS AND LOANS (%)

TYPE OF ACCOUNT OR LOAN	DATE	US	DISTRICT	ARIZ	CALIF	HAWAII	IDAHO	OREGON	UTAH	WASH
MONEY MARKET DEPOSIT ACCOUNTS	DEC89	6.43	6.26	6.02	6.50	5.97	6.03	6.17	6.45	5.81
	JAN90	6.37	6.22	5.92	6.47	5.87	6.05	6.08	6.46	6.02
	FEB90	6.32	6.21	5.89	6.47	5.68	6.07	6.13	6.45	6.18
92 TO 182 DAYS CERTIFICATES	DEC89	7.83	7.54	7.47	7.94	6.96	7.66	7.87	7.62	7.17
	JAN90	7.75	7.47	7.46	7.73	6.89	7.50	7.70	7.72	7.14
	FEB90	7.76	7.47	7.43	7.76	6.89	7.45	7.77	7.78	7.06
2-1/2 YEARS AND OVER CERTIFICATES	DEC89	7.86	7.76	7.74	7.90	7.76	7.85	7.73	7.76	7.77
	JAN90	7.86	7.74	7.71	7.89	7.57	7.93	7.82	7.77	7.74
	FEB90	7.87	7.86	7.67	7.91	7.57	7.96	8.45	7.94	7.75
COMMERCIAL, SHORT-TERM*	AVE. RATE	9.93	9.80	9.57	9.55	9.63	11.90	10.53	11.22	10.34
	AVE. MAT. (DAYS)	43	66	105	39	90	177	85	92	136
COMMERCIAL, LONG-TERM*	AVE. RATE	10.92	10.80	11.30	10.99	N/A	N/A	10.29	11.92	10.64
	AVE. MAT. (MONTHS)	46	59	82	65	N/A	N/A	57	30	30
LOANS TO FARMERS*	AVE. RATE	11.78	10.52	10.40	10.25	9.75	11.41	10.82	12.99	10.95
	AVE. MAT. (MONTHS)	13	8	4	7	N/A	29	5	44	15
CONSUMER, AUTOMOBILE	AVE. RATE	11.80	12.19	N/A	12.49	N/A	13.50	10.83	11.97	11.29
CONSUMER, PERSONAL	AVE. RATE	15.27	16.17	N/A	19.73	N/A	13.50	13.89	17.32	14.84
CONSUMER, CREDIT CARDS	AVE. RATE	18.12	18.39	N/A	19.44	N/A	N/A	19.24	20.00	16.50

SOURCES: SURVEY OF TERMS OF BANK LENDING AND TERMS OF CONSUMER CREDIT; MOST COMMON INTEREST RATES ON SELECTED ACCOUNTS.

* U.S. DATA ARE COMPOUNDED ANNUAL RATES, DISTRICT AND STATE DATA ARE SIMPLE ANNUAL RATES.